Nottinghamshire
County Council

Pensions Sub-Committee

Thursday, 06 February 2014 at 10:00

County Hall, County Hall, West Bridgford, Nottingham NG2 7QP

AGENDA

1	Minutes of last meeting held on 7 November 2013	5 - 8
2	Apologies for Absence	
3	Declarations of Interests by Members and Officers:- (see note below) (a) Disclosable Pecuniary Interests (b) Private Interests (pecuniary and non-pecuniary)	
4	To note the appointment of Terence Victor Needham and Shaun Haggerty as the Pensioner Representative	
5	Proxy Voting	9 - 12
6	Local Authority Pension Fund Forum Conference, Bournemouth	13 - 22
7	Working Party Recommendations	23 - 48
8	Triennial Valuation-Initial Results	49 - 50
9	Operation of the In-House Team and Portfolio	51 - 54
10	Work Programme	55 - 58

NOTES:-

(1) Councillors are advised to contact their Research Officer for details of any Group Meetings which are planned for this meeting.

(2) Members of the public wishing to inspect "Background Papers" referred to in the reports on the agenda or Schedule 12A of the Local Government Act should contact:-

Customer Services Centre 0300 500 80 80

(3) Persons making a declaration of interest should have regard to the Code of Conduct and the Council's Procedure Rules. Those declaring must indicate the nature of their interest and the reasons for the declaration.

Members or Officers requiring clarification on whether to make a declaration of interest are invited to contact Ruth Rimmington (Tel. 0115 9773825) or a colleague in Democratic Services prior to the meeting.

(4) Members are reminded that Committee and Sub-Committee papers, with the exception of those which contain Exempt or Confidential Information, may be recycled.

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Nottinghamshire County Council

minutes

Meeting	PENSIONS SUB COMMITTEE
Date	Thursday, 7th November 2013 at 10.00 am

membership
Persons absent are marked with `A'

COUNCILLORS

S Smedley MBE JP (Chairman)
Ken Rigby (Vice Chairman)

Reg Adair
Chris Barnfather
Mrs Kay Cutts
A Glynn Gilfoyle
Sheila Place
Darrell Pulk
Parry Tsimbiridis

<u>Nottingham City Council</u>

A Councillor Alan Clark
Councillor Thulani Molife
A Councillor Jackie Morris

<u>Nottinghamshire Local Authorities' Association</u>

Executive Mayor Tony Egginton
A Councillor Milan Radulovic MBE

<u>Trades Unions</u>

A Mr J Hall
Mr C King

<u>Scheduled Bodies</u>

A Mr N Timms

<u>Pensioners</u>

2 Vacancies

<u>Officers in Attendance</u>

Simon Cunnington	(Environment & Resources)
Keith Ford	(Policy Planning and Corporate Services)
Nigel Stevenson	(Environment & Resources)

Sarah Stevenson (Environment & Resources)

Others in Attendance

Karen Thrumble (WM Company)

MINUTES

The minutes to the last meeting of the Sub-Committee held on 16th July 2013, having been previously circulated were confirmed and signed by the Chairman.

APOLOGIES FOR ABSENCE

Apologies for absence were received from:-

Councillor Glynn Gilfoyle	-	(other County Council business)
Councillor Jackie Morris	-	(medical / illness)

DECLARATIONS OF INTEREST BY MEMBERS AND OFFICERS

None

LOCAL GOVERNMENT CONFERENCE INVESTMENT SUMMIT 2013

RESOLVED 2013/006

(1) That it be noted that attendance at key conference was part of the Fund's commitment to ensuring those charged with decision making and financial management have effective knowledge and skills.

(2) That the report be noted.

PROPERTY INSPECTION 2013

During discussions, Members requested that future such reports include details of those members who had attended the tour.

RESOLVED 2013/007

(1) That it be noted that attendance at key conference was part of the Fund's commitment to ensuring those charged with decision making and financial management have effective knowledge and skills.

(2) That the report be noted.

WORKING PARTY RECOMMENDATIONS

During discussions, Members requested that future such reports include details of those members who had attended the working party meeting.

RESOLVED 2013/008

(1) That the portfolio benchmark be changed to:-

i. reduce the weighting to gilts;
ii. increase the weighting to corporate bonds;
iii. remove overseas government bonds entirely.

(2) That the manager be given flexibility to invest up to 10% in 'high-yield' bonds.

(3) That the index-linked bonds be transferred to the Inflation Linked Fund.

LOCAL AUTHORITY PENSION FUND FORUM (LAPFF)

RESOLVED 2013/009

That approval be given to Sub-Committee Members' attendance at LAPFF business meetings.

PROXY VOTING

RESOLVED 2013/010

That the report be noted.

INVESTMENT PERFORMANCE REVIEW 2012/13

Karen Thrumble of WM Company attended the meeting and presented the Fund's Annual Performance Review, including comparisons with other pension funds in the UK.

RESOLVED 2013/011

That the contents of the report and the presentation be noted.

WORK PROGRAMME

RESOLVED 2013/012

That the Sub-Committee's work programme be noted.

The meeting closed at 11.15 am.

CHAIRMAN
M_7Nov2013

Nottinghamshire County Council

Report to Pensions Sub-Committee

06 February 2014

Agenda Item:5

REPORT OF SERVICE DIRECTOR – FINANCE & PROCUREMENT

PROXY VOTING

Purpose of the Report

1. To report on the voting of equity holdings in the final quarter of 2013 (calendar year).

Information and Advice

2. The *UK Stewardship Code*, issued in September 2012 by the Financial Reporting Council, highlights the responsibilities that institutional investors have with regard to the “long-term success of companies in such a way that the ultimate providers of capital [in this case, the Nottinghamshire Pension Fund] also prosper”. These responsibilities include, among other things, having a clear policy on voting and on the disclosure of voting activity. The *Code* states that investors “should not automatically support the board”.

3. Alongside this the CIPFA *Principles for investment decision making and disclosure* require administering authorities to include a statement of their policy on responsible investment in the Statement of Investment Principles and report periodically on the discharge of such responsibilities. The Fund’s statement on responsible investment states that “the Fund continues to exercise its ownership rights by adopting a policy of actively voting stock it holds”.

4. The Fund retains responsibility for voting (rather than delegating to its investment managers) and votes the majority of its equity holdings in the UK, Europe, US and Japan. Voting is implemented by Pensions Investment Research Consultants (PIRC). PIRC issue Shareholder Voting Guidelines each year and the latest version places even greater emphasis on management of shareholders’ capital and remuneration policies. PIRC use these guidelines when implementing voting on behalf of the Fund.

5. During the final quarter of 2013, 57 meetings were held with a total of 611 voting resolutions. A list of all meetings held during the period together with analysis of voting at each meeting will be available on the Fund’s website at: http://www.nottspf.org.uk/pensionfund/voting/.

6. Overall, 22% of the votes cast were not in favour of the resolutions with Europe and the US having the highest percentage of oppose votes at 24% and 33% respectively. The UK meetings had 12% of oppose votes. The main oppose votes were on directors appointments, executive pay schemes and remuneration reports. This demonstrates that the Fund continues to take it stewardship role seriously through considered exercise of its voting rights. A summary of the voting is shown in the table below.

Geographic Region	Resolutions		For		Oppose		Abstain		Withheld		Non-Voting		Not Supported	
NORTH AMERICA	248		123	49.6%	82	33.1%	12	4.8%	31	12.5%	0	0.0%	0	0.0%
UK	260		201	77.3%	31	11.9%	27	10.4%	0	0.0%	1	0.4%	0	0.0%
EU	99		46	46.5%	24	24.2%	13	13.1%	0	0.0%	15	15.2%	1	1.0%
JAPAN	4		2	50.0%	0	0.0%	2	50.0%	0	0.0%	0	0.0%	0	0.0%
REST OF THE WORLD	0		0		0		0		0		0		0	
Total	611	100.0%	372	60.9%	137	22.4%	54	8.8%	31	5.1%	16	2.6%	1	0.2%

Extracts from PIRC's quarterly report

7. The last Quarterly Report outlined proposals from the Competition Commission to reform auditor selection and governance processes for FTSE 350 companies, including rotation and reporting to shareholders as part of its Statutory Audit Services Market Investigation.

8. The Financial Reporting Council (FRC) has now responded to these proposals in a letter sent to the Competition Commission. The FRC does not support, or seeks amendments to, many of the proposals and has undertaken to conduct a further consultation later in 2014 around changes to the UK Corporate Governance Code. The response can be viewed at the FRC website. In respect of its proposed remedies, the Competition Commission is expected to publish a draft Order in late January 2014.

9. The latest report from PIRC highlights another interesting idea, which was contained in the recent Parliamentary Commission on Banking Standards (PCBS) report: that shareholder primacy should be removed at the banks. The proposal was included in the Business, Innovation & Skill (BIS) consultation paper *Transparency & Trust*.

10. The idea has already been rejected by the FRC (which argued that 'if shareholder primacy is removed it may affect the ability of banks to attract future capital') and the Institutional Investor Committee. The idea was given a more positive welcome by the TUC, possibly as an opportunity to discuss other governance models where employees play a greater role. Possibly the most surprising response to the BIS consultation came from the Institute of Directors (IoD) who, although not agreeing with amending company law as proposed by the PCBS, is sympathetic to the thrust of the proposal.

11. The IoD is quoted as saying 'we agree that the directors of systemically important financial institutions have wider responsibilities than simply promoting the interests of shareholders… In an ideal world, systemically-important financial institutions (or other organisations that are "too big or important to fail") would adopt some other corporate legal framework in which directors' fiduciary duties were explicitly framed in terms of promoting broader social or stakeholder objectives, such as the stability of the financial system.' This view could be regarded as a major change from established governance principles.

Statutory and Policy Implications

12. This report has been compiled after consideration of implications in respect of finance, the public sector equality duty, human resources, crime and disorder, human rights, the safeguarding of children, sustainability and the environment and those using the service and where such implications are material they are described below. Appropriate consultation has been undertaken and advice sought on these issues as required.

RECOMMENDATION/S

1) That the report be noted.

Report Author:
Simon Cunnington
Senior Accountant – Pensions & Treasury Management

For any enquiries about this report please contact: Simon Cunnington

Background Papers and Published Documents

Except for previously published documents, which will be available elsewhere, the documents listed here will be available for inspection in accordance with Section 100D of the Local Government Act 1972.

- PIRC Notts Quarterly Report Q4 2013
- Financial Reporting Council, The UK Stewardship Code, September 2012.
- FRC's letter to the Competition Commission (9/1/2014): http://www.frc.org.uk/Our-Work/Publications/FRC-Board/FRC-Letter-to-Competition-Commission-re-Statutory.pdf

Nottinghamshire County Council

Report to Pensions Sub-Committee

6 February 2014

Agenda Item:6

REPORT OF SERVICE DIRECTOR – FINANCE & PROCUREMENT

LAPFF CONFERENCE 2013

Purpose of the Report

1. To report on the LAPFF Conference 2013 held in Bournemouth.

Information and Advice

2. The LAPFF Conference 2013 was held on 4th to 6th December 2013 at the Highcliff Marriott Hotel in Bournemouth. In accordance with prior approval and as part of the Fund's commitment to ensuring those charged with decision-making and financial management have effective knowledge and skills; the conference was attended by Councillor Darrell Pulk and Mr Nigel Stevenson (Group Manager – Financial Strategy and Compliance). The theme of this year's conference was Licence to Operate: Holding Companies to Account.

3. ***David Pitt-Watson – Executive Fellow, London Business School***
   The conference began with David Pitt-Watson reflecting back on the history of improving corporate governance arrangements in British companies, starting with the Cadbury Committee report in the early 1990's. This report set out recommendations on the arrangement of company boards and accounting systems to mitigate corporate governance risks and failures. The Committee's aims were to investigate the British corporate governance system and to suggest improvements to restore investor confidence in the system.

   The report's recommendations have been used to varying degrees to establish other codes such as those of the European Union and in the United States and David reflected upon his involvement in helping shape some of these codes.

   David set out the objectives of the LAPFF Conference, which would explore today's issues with corporate governance and the engagement opportunities that investors should utilise.

4. ***Does activism enhance company value for investors?***
   This session began with David Trenchard, Vice Chairman of Knight Vinke explaining what activism was about. This investment approach involves, to varying degrees, taking opportunities in undervalued companies or companies with governance issues and by investment taking a more active role in improving governance and financial performance. Knight Vinke invests in large companies (including multi-nationals) with only relatively small holdings, and their edge is by way of very deep forensic financial analysis. David talked

about long term engagement, over holding periods longer than 3 years, directly with the boards of these companies all aimed to improve financial performance.

This was followed by Alex Pauisco, CEO and Founding Partner, DBay Advisors, who explained his company's approach to activism mainly in US companies. The strategy in the USA varies due to the different legislation affecting investors from that in the UK and Europe. The strategy therefore tends to appear more aggressive. However, their approach is similar to Knight Vinke in undertaking very detailed forensic financial analysis, again with relatively small shareholding in companies. The holding is typically only 5% but an amount that is sufficient to obtain rights in adding items to company AGMs. Again this enables direct engagement with company boards with the aim to improve financial performance, although the specific example provided did appear to be more related to financial engineering by a review of the value of the assets held on the balance sheet.

Bryan Schneider, Senior Vice President, Entrust Capital Inc. followed with insights again mainly drawn from experiences of activism in the USA from a very large activist fund perspective. It is typical that activist managers build up a network of success both in being able to introduce new managers to companies to improve performance and in them being able to spot effective strategies to improve companies. This experience also enables them to recognise other investors that would follow these activist managers and invest in the new opportunity to add value to the company.

Directors of companies sometimes do not understand the value in the company and the traditional investor doesn't have the resources to do the deep financial analysis that is required. Likewise, the activist manager may miss opportunities because they spend so much time analysing data but all three speakers indicated that they get it right more times than wrong.

It was stressed by all three speakers that this wasn't short-term investing; however, the longest example provided by any of the speakers was a 5 year investment. And again, due to the very nature of the financial analysis required the activist managers would typically only hold stock in 10 companies and only ever be active in 6 of these at any one time.

5. ***National LGPS Procurement Framework. 'How to save your fund time and money'***
Nicola Mark, Head of Norfolk Pension Fund led a small session on the progress being made on the collaborative procurement framework, which is open to all LGPS to use. A number of services, including actuary and advisory services were already on the framework and although there is a charge to use the framework of £7,000 - £8,000 the more LGPS using the framework would increase the rebate available to the users. Using the framework would reduce the time and cost in tendering for a number of services.

6. ***Audit and Accounting (IFRS)***
Tim Bush from PIRC Ltd and Ian Richards from Threadneedle Investments presented an update since the publication by LAPFF entitled 'UK and Irish Banks Capital Losses - Post Mortem' and Ian's publication entitled 'Bringing Audit Back from the Brink'. Both papers looked at the near total collapse of the UK and Irish capital adequacy regimes where it became clear that those charged with setting accounting standards had made errors in those standards particularly related to banks. In addition, the auditors were heavily criticised for failing to spot the bad practices that contributed to the onset of the financial crisis in

2008, while the Financial Reporting Council's (FRC) ongoing audit inspections have already identified various failings in how financial institutions are audited.

Both Tim and Ian were concerned that no changes are proposed to the accounting standards and they believe losses of £50bn still exist in the banking system. In May 2013 LAPFF, together with the Investor Coalition, sought advice from a leading QC (George Bompas). His opinion indicated that company law should prevail over accounting standards which is not showing a ‘true and fair view’ of banks’ balance sheets and that some specific IFRS outcomes are problematic.

Recently LAPFF has published a follow up report as a result of criticism from the Financial Reporting Council (FRC). This set out the arguments put by LAPFF as to the systematic failure of the accounting standards regime and the underlying issue of the backward looking loan loss provisioning model that made sub-standard lending appear highly profitable. Both speakers indicated that it was disappointing that five years on from the banking crisis very little has been done to address the inadequacies in the accounting standards.

Since the LAPFF conference the Financial Reporting Council (FRC) has announced (13 December 2013) that it will conduct a formal review of banks audits in the second quarter of 2014 as soon as this year's annual reports have been completed to find out why progress in improving their quality has been so slow. “Concerns about the quality of auditing of banks and building societies persist," said Baroness Hogg, chairman of the FRC. "The issues and concerns that have been raised mean that a specific review of audit in this sector is warranted”.

7. ***Licence to Operate: Community responsibilities of companies***
Josh Hardie, Corporate Responsibility Director, Tesco PLC spoke about Tesco’s approach to addressing community responsibility issues, such as helping to reduce obesity, reducing food waste, creating opportunities for young people through apprenticeships and charitable activities such as helping to provide food for people in poverty. Josh indicated that some of these initiatives were delegated to local stores discretion and that contributing to these initiatives was maintaining customer loyalty, which added to the company bottom-line.

8. ***Holding the rating agencies accountable***
The session was led by Dan Drosman, a partner in Robbins Geller Rudman & Dowd, who led a group of attorneys in the USA prosecuting fraud claims against the credit agencies, where he was distinguished as one of the few plaintiff’s counsel to defeat the rating agencies’ traditional First Amendment defence and their motions summary judgment based on the mischaracterisation of credit ratings as mere opinions not actionable in fraud. Dan’s ground-breaking prosecution of the ratings agencies was the subject of multiple media articles in national and international publications.

Dan’s speech ran through the history of rating financial products. Prior to 2007 the 2 times where triple ‘A’ ratings had failed were during the Spanish Civil War and WW2. By 2007 a number of investor failures appeared. Dan outlined the particular case in 2008 when the hedge fund Chyene Capital Management Ltd. took legal action against Standard & Poor’s and Moody’s Investor Service Inc. who had given unwarranted investment-grade (AAA) ratings in 2006 to $23bn worth of notes backed by subprime mortgages, the same seal of approval US Treasury bonds get.

Following the disclosure of a vast quantity of internal company emails and correspondence, early in 2013 both rating agencies settled the lawsuits with less than a week before the scheduled start of the first trial.

Dan indicated that it became clear that the rating agencies were driven by the need to hand gold-plated triple A credit ratings to vehicles in order to win fees, despite knowing that risks were building in the underlying subprime mortgages. He raised particular concern that the same mistakes will be made unless more structural reform is undertaken. Change will happen but the incentive scheme will probably force things to change back to the obvious current scheme. Proposed alternatives included removing the regulations that require deals/vehicles to obtain ratings or suggesting that prospective purchasers pay for the rating rather than the seller.

9. ***Social impact investing***

The session was led by Brian Bailey, from PIRC Ltd, and Councillor Kieran Quinn, Chair of LAPFF, who began with a definition of Social Impact Investment as “Use of repayable finance to produce social as well as financial returns. Social returns result in improved outcomes for individuals and communities particularly amongst less well-off groups, e.g. improved health and wellbeing, higher levels of employability, reduced social problems and improved environment”.

LAPFF commissioned the Smith Report which surveyed the opinion of a small number of pension funds; explored the reasons pension funds do not invest in social impact investment, tested the demand for such investments, identified key opportunities and barriers and made recommendations on what stakeholders might do to enable changes in practice. The recommendations of the report were better information and clearer guidance; demonstrate case studies and training to match impact investing with fiduciary duties, legislative changes and the creation of opportunities for investment.

As a consequence the five funds together, under the banner of the I4G initiative, invited asset managers to submit proposals that could meet an impact investing brief. The brief required asset managers to demonstrate they had an institutional quality product by providing information covering their good standing, experience, investment process, risk management arrangements, operating structure, fees, costs etc. In addition, to provide details of the impact of their investment activity identifying economic, social, environmental and geographic (in terms of deprivation and fund operating areas) impacts.

Although initially there were over 30 submissions by managers a number of challenges to the investment opportunities have arisen, namely;

- Opportunities come from relatively small investment funds resulting in relatively higher fees
- High relative supervision costs by pension funds due to small scale of investments
- Need to create a portfolio of investments in order meet risk management requirements and improve value for money (i.e. a fund of fund approach)
- Unfamiliar nature of some activities, asset managers and key personnel
- Categorising and evaluating the impacts
- Risk of being first
- Identifying an asset allocation and compliance with the fund’s SIP
- Co-ordination of the 5 pension funds’ due diligence and approval processes.

As a consequence to date only 7 propositions are in the detailed evaluation process which may lead to some or no investment opportunities, the outcome of which will not be known until early in the New Year.

10. ***Good Directors***

Jim O'Loughlin, PIRC Ltd chaired the next session, which began with Sacha Sadan, Director of Corporate Governance at Legal & General Investment Management, setting out the work he does with companies to improve the effectiveness of directors. L&G performs a highly active role in engaging with companies in which it invests, seeking to deliver the best possible long-term value for shareholders. Sacha's presentation concentrated on the essential qualities for a good director:

- Leadership
- Credibility and independence
- Listens to stakeholders
- Talent
- Thinks like an owner
- Being accessible
- Receptive to information/challenge

The outcomes from this work are sustainable returns, longevity (fewer turnovers of directors), strong succession pipeline, better able to navigate competitive environment, good relationships with stakeholders and lower costs of capital for companies. Sacha set out the framework L&G use for Directors, including majority of board independence, Chairman/CEO role split, annual re-election of directors, limiting the number of directorships held, external evaluation of the Board every 3 years and Lord Davies' targets for diversity, set out below:

- All heads of FTSE 350 companies should set out the percentage of women they aim to have on their boards in 2013 and 2015
- FTSE 100 boards should aim for a minimum of 25% female representation by 2015
- Each year, quoted companies should be required to disclose the proportion of women on the board, women in senior executive positions and female employees in the whole organisation
- Company bosses should disclose meaningful information about their firms' appointment processes and how they address diversity in annual reports
- Recruitment firms should draw up a voluntary code of conduct addressing gender diversity and best practice covering FTSE 350 board level appointments

In responding to questions, Sacha explained that it was important that company boards also listen to their employees, however, that does not necessarily mean employees have to sit on company boards. In addition, companies should reward all employees for company achievements not just the few at the top. Sacha indicated some companies had raised issues on who would conduct external evaluation, however he was determined that standards should be set for these reviews and boards should conduct internal reviews of their effectiveness etc. more regularly.

Tom Dobell, M&G Recovery Fund, explained their approach, setting out the companies that they invest in, particularly looking for unloved companies, ensuring the problems are transitory or solvable and taking a long-term view. Tom concentrated on explaining the direct involvement they have with company Chairmen and independent directors.

The Chairmen that run the Board should have the appropriate profile, strike the right balance of involvement, determine the corporate culture and assess and challenge the Chief Executive. Independent directors should have complementary skills through their breadth of perspective and experience, demonstrate commitment ("don't walk when the going gets tough") and the right chemistry to be supportive but challenging when required. Tom then used an example of their work with Easyjet which had both public operational and boardroom problems. Tom indicated that M&G were instrumental in allowing the new management team to be introduced in 2010 and they worked closely with other shareholders and the new management to develop the business. This resulted in a turnaround of the business, with increased profits and the introduction of dividend payments. Throughout Tom's presentation he stressed that the most important factor that defined a good director and chairman was trust.

Deborah Gilshan, Corporate Governance Counsel for RPMI Railpen Investments, concluded the session by explaining Railpen's direct company engagement and market policy work to address corporate governance risk and improve shareholder rights in the markets in which Railpen invests. Her examples were drawn from the USA where director accountability and board structure is behind the UK and where no codes of governance exist.

11. ***Climate risk: stranded assets, fracking and CapEx challenges***

Craig Mackenzie, Head of Sustainability, Scottish Widows Investment Partnership, began the session with the fact that it is estimated that 15-20% of Pension Fund equity holdings is in the fuel sector, consequently, climate change policies are very important to pension funds, as they pose a huge long-term risk to fossil fuel revenues.

Craig indicated that coal producing companies in the USA are seeing their share price fall drastically as they move to shale gas. In addition, analysts believe demand for coal in China will peak soon and the overall feeling was that World demand for oil will peak in 2020. As a consequence, with the cost of production varying across the World, as demand for oil falls those areas with low cost of production such as Brazil and the Middle East, oil production will remain profitable, whereas in the USA, where the cost of production is high, will see oil extraction reduce; leading to potential 'stranded assets'. As a result there is a need now to engage with companies in the fuel sector to understand individual company positioning against this demand risk, as their capital expenditure strategy will follow this fossil fuel future cost-curve and the need to understand their diversification strategies.

In the opposite corner, was Sarah Telik, a senior vice president of Apache Corporation, who was sceptical with Craig's analysis on the future demand for fossil fuel. She didn't deny it would happen, more so the timelines as to when it would transpire. She then explained that major oil producers only include proven oil reserves in their accounts; those reserves that have been proved to exist and the cost of extraction can be reasonably estimated, which is different to possible or probable reserves. Hence, company accounts would never be affected by the 'stranded assets' issue, although there is real concern over being able to replace these assets once they have been used.

She went on to explain that alternatives to fossil fuels can be more expensive due to equipment and technology costs, and China's rush for reserves is more a geopolitical desire to hold reserves (not all proven) rather than to achieve a rate of return, which distorts the market. She gave a robust defence to the effect of climate change and also indicated that coal prices were falling in the USA prior to the expansion in shale gas production.

Sandwiched between these counter arguments Faith Ward, from the Pension Fund Management Team in the Environment Agency, explained the EA involvement in industry wide initiatives to improve standards in responsible investment. Faith outlined the implications of the 'Green Light Report' launched by ShareAction in October 2013, which aims to assist pension funds by guiding them through the financial implications of climate change and the steps they can take in light of the risks and opportunities it presents. Taking a holistic approach, the report examines the following four key areas:

- Setting internal frameworks for managing climate risks
- Addressing carbon intensive portfolios
- Investing in a low carbon future
- The role of public policy

In essence it asks pension funds to have a policy and provide training on carbon risk, to evaluate carbon risks in their portfolios, to challenge capital allocation of underlying hydrocarbon companies and to look to low carbon alternatives.

12. ***Councillor Kieran Quinn – Chair of LAPFF***

With the overnight news of the death of Nelson Mandella the second day began with a moment of reflection, led by Cllr Kieran Quinn and Cllr Peter Brayshaw, London Borough of Camden, on the life of and their personal experiences of meeting Mr Mandella.

13. ***Media standards debate***

This session commenced with Martin Hickman, formally a journalist with the Independent, who is now reporting on the phone hacking trial for the campaign group Hacked Off. With Tom Watson, he is author of the book on the phone hacking scandal, Dial M for Murdoch: News Corporation and the Corruption of Britain.

Martin began by the re-telling of the phone hacking story, why it mattered and what can be done to prevent it happening again. He re-iterated that it was more than just phone hacking and covered more of unethical behaviour and corruption of public officials. This had caused huge harm to individuals and major corporations, and struck at the heart of public confidence since the press were seen as the police of last resort. A recent public survey indicated that corruption in the media is considered high which in the current climate of bankers is quite significant. Tom was obviously in favour of tighter press regulation, moving from the current arrangement of the club of editors through the PCC to Lord Leveson's view of independent regulation.

Dr Evan Harris, former Liberal Democratic MP and now representing the campaign group Hacked Off, continued with the theme set out in Tom's speech. He thought it ironic that owners of newspapers, who regularly argue for tighter regulation and standards for bankers and doctors, should think this does not apply to them. In his view the tighter regulation process would protect the public and journalists and would provide newspapers some level of protection from excessive legal claims if they accepted the proposed regulation changes. Sitting outside of this process would lead to higher legal claims/costs, as well as reputational risk, and make some newspaper companies insolvent. Hence, this was a corporate governance issue and one that shareholders, such as the LGPS, should be involved in by forcing these companies to accept the proposed regulations (which are still voluntary).

14. ***The future of the Local Government Pension Scheme***

This session was an open debate chaired by Brain Bailey, from PIRC Ltd, with Terry Crossley, former Deputy Director at the DCLG, and Councillor Kieran Quinn, Chair of LAPFF.

In response to a question on the sustainability of the LGPS, Terry indicated that the changes to the benefit system (CARE) was meant to be sustainable for the next 20 years, however employee rates should maybe have been higher to ensure sustainability and that the 2019 valuation may prove to be the most important valuation as April 2020 was the next opportunity to change the benefit structure. Kieran indicated there was continual uncertainty on cost sharing and contribution rates, as there is with investment returns, so there was always an issue of sustainability.

On the subject of the Scheme Advisory Board (SAB), Kieran felt it was probably too early to indicate whether this was proving to be effective. Both felt the role of the Pension Regulator was confused and this was high on the list of topics to be discussed by the SAB. There was concern raised on the increase in the number of employers in the LGPS and a potential that the SAB would be too remote from all employers in the various pension funds. Terry indicated that he felt with the SAB the danger was the Minister would be too far removed from local authorities and that new tensions would emerge if the SAB set too ambitious a programme of work. He went to on indicate that local accountability was paramount and felt Government does not understand the role of local councillors in managing the LGPS.

Expanding further on the issues of tensions between the Minister, SAB and local authorities, Terry expressed concern that HM Treasury's role added a potential additional tension with the setting of funding levels for all pension schemes, including the LGPS. He did not feel that the HMT had a desire to hold all the assets; however you can surmise that the desire to merge funds may be a step towards this.

On the specific issue of merging of funds, Kieran indicated that there had been over 130 responses on the call for evidence and the SAB were due to review these at a meeting before Christmas. Kieran felt the answer was more collaboration rather than merging. Terry's view was that merging was not necessarily the answer. If local government can make a success of collaboration and working together then the argument for merging disappears. Local accountability is important and who in their right mind would want to amass all the liabilities in 1 or even 8 big funds.

15. ***Investor collaboration***

A very short debate, chaired by Councillor Quinn, with Daniel Godfrey, CEO Investment Management Association, Janet Williamson, representing the Trade Union Shareholders (TUC), Richard Nunn, from the United Reformed Church and Chair of the Church Investors Group, and Amy Borrus, Deputy Director of the Council of Institutional Investors (USA).

Daniel Godfrey began by setting out the work of the Investor Forum, with the aim to work with companies to improve investor outcomes and move from short-term towards long-term thinking. There was a circle of virtue of those with capital (investors), asset managers (fund managers etc.) and companies that ultimately would lead to increased long-term returns for the benefits to the various beneficiaries of funds. He explained the work of the Investor Forum had not been as expected since only 50% of the market is owned by UK investors so there was a need to work more closely with sovereign wealth funds and foreign investors. It was hoped that LAPFF members would join the Investor Forum over the next 12 months.

Janet Williamson explained how the TUC has taken more interest in shareholder activity and their aim for all union pension funds coming together to vote in line with trade union values at AGMs. There were initial tensions with fund managers not necessarily reflecting union values in voting so as a consequence the TUC has written guidelines for all fund managers to follow. Presently only 3 of these pension funds (including UNITE and UNISON) representing £1 billion of investments, manage their voting rights together but hopefully more will join in due course.

Richard Nunn explained how the Church pension funds have a collaborative agreement over governance, ownership responsibilities and on voting along shared ethical values.

Amy Borrus' speech concentrated on the differences between the USA and UK on these issues and indicated that the UK leads the way on shareholder engagement and improving company governance. The Council of Institutional Investors was formed in 1985 and has grown to over 120 members representing both corporate and public pension funds, as well as some union and endowment investors; with a mix of voting and non-voting members (8 of the non-voting members are from the UK). In total the organisation represents over $3 trillion invested in USA companies. All members share fund similarities, such as long-term investor horizons and indexing strategies. Amy ran through the history of governance issues in US companies and the impact collaboration of institutional investors has made on improving corporate governance, increasing financial oversight and setting out the responsibilities of Directors and Boards of Companies.

16. **Investor Capitalisation**

The conference concluded with a lively, if not relatively short speech, by Lord Myners, Chairman of Cevian Capital (UK) LLP. This started with the comparison between the tyranny and voting system in North Korea to the Chairman's powers in UK companies and the process of election for a successor Chairman. Various committees have reviewed company governance, from Cadbury, with no discernible changes. Most of the issues arise because of the diversified ownership. In the 1970s fund managers would have had between 20-25 stocks in a portfolio whereas now this has increased to typically over 200.

He went on to suggest that managing fund manager's relative performance to benchmarks is an illusion as it does not reflect risk or how your money is managed. He also indicated that the term of underweight means they suggest the marketplace will do worse than a randomly chosen mix; and you pay them a fee! It is nonsense to suggest they will engage with companies if you are managing performance on 90 day reviews unless you are using these to manage fund manager's longer term performance. Basically his argument was against short-termist investment as fund managers will concentrate on the return you want rather than good corporate governance.

Lord Myners then turned to the work of the Investor Forum. His comments were that it was staffed part time, was late in forming and had planned funding for only 2 years. Although its aims were laudable he was sceptical that it would improve governance, especially as it is backed by investment managers.

He concluded his speech by indicating that LGPS investors do not have enough information to engage with fund managers, to beat them up on performance or to ensure they are doing work on improving corporate governance. Nor did he feel collaboration on voting was the solution.

Statutory and Policy Implications

17. This report has been compiled after consideration of implications in respect of finance, equal opportunities, human resources, crime and disorder, human rights, the safeguarding of children, sustainability and the environment and those using the service and where such implications are material they are described below. Appropriate consultation has been undertaken and advice sought on these issues as required.

RECOMMENDATIONS

1) That it be noted that attendance at key conferences is part of the Fund's commitment to ensuring those charged with decision-making and financial management have effective knowledge and skills.
2) That the report be noted

Report author:
Nigel Stevenson
Group Manager – Financial Strategy and Compliance

For any enquiries about this report please contact: Nigel Stevenson

Background Papers
None

Nottinghamshire County Council

Report to Pensions Sub-Committee

06 February 2014

Agenda Item: 7

REPORT OF SERVICE DIRECTOR – FINANCE & PROCUREMENT

WORKING PARTY RECOMMENDATIONS

Purpose of the Report

1. To seek agreement to the recommendations of the Pensions Working Party in respect of the Fund's property portfolio.

Information and Advice

2. A meeting of the Pensions Working Party was held on 27 January 2014 to discuss the Fund's property portfolio. The following members of the Sub-Committee attended:

Councillor Ken Rigby	County Councillor
Councillor Reg Adair	County Councillor
Councillor Darrell Pulk	County Councillor
Mr C King	Trade Union Representative
Mr N Timms	Scheduled & Admitted Bodies' Representative
Mr Eric Lambert	Fund Independent Adviser

3. Attached are the reports provided to the Working Party as background information. Two representatives from Aberdeen attended the meeting to present their proposals for the main portfolio. After the presentation, the Working Party discussed the following:
   a. The desired level of risk and target allocations within the Fund's main property portfolio
   b. The level of cash available to Aberdeen for additional investment
   c. Whether to consider local property investments
   d. Whether to make additional investments in property.

4. The Working Party members agreed that a reasonable long term return expectation for property is 6.5% pa net of fees. This exceeds the assumed returns from property within the actuarial valuation of the Fund and is in line with the average annualised income return over the last 42 years (as shown in Aberdeen's Paper 1, p3). By setting this target return, the implicit assumption is that only a small element of return is expected to come from capital growth (over the long term) and this indicates the portfolio will be relatively low risk.

5. Aberdeen's investment process is outlined in their Paper 2 and categorises assets within a portfolio to help manage risk. A 'Core' portfolio is recommended to 'deliver durable income over the long term'. The target ranges within each category of assets within a 'Core' portfolio are shown in Table 1 below. The Working Party members agreed that these target ranges were appropriate for the Fund within the investment approach used by Aberdeen.

Table 1

Categorisation	Core
Long term hold	50 – 70%
Asset manage long term hold	10 – 20%
Asset manage short term hold	0 – 20%
Immediate sale	0 – 10%

6. As described on page 8 of Aberdeen's Paper 2, a 'Core' portfolio is likely to underperform in a rising market (as investors favour more risky assets) but outperform when the market turns. Performance (and particularly performance relative to the benchmark) will therefore need to be viewed over the long term. Reporting to the Pensions Investment Sub-Committee has already been amended to focus more on returns over 3, 5 and 10 year periods.

7. Aberdeen have recently been recommending the sale of a number of lower quality assets and the purchase of higher quality assets with longer, more durable income streams. This process is ongoing and the Working Party members recommended that the proceeds of sales within the main portfolio continue to be re-invested in line with the recommended asset categories above.

8. As the attached Working Party report shows, the Fund is currently underweight in property compared to the strategic benchmark. This has come about more from relative movements in valuations of different asset classes than from an active decision of the Fund and has been of overall benefit recently as equities, in particular, have outperformed other assets. However, members of the Working Party felt that property investments should now be brought closer to the benchmark allocation, either from unallocated cash or from a reduction in the equities allocation (or a combination of both).

9. At the last Investments Sub-Committee in December 2013, the possibility of making 'local' property investments was raised and it was suggested that this should be discussed at the Working Party. Members of the Working Party felt that it would not be sensible to specify particular investments within the main portfolio as this would be likely to move the risk/return characteristics of the portfolio outside the parameters being recommended. After further discussion, no recommendation was made to include 'local' investments.

10. The recommendations of the Working Party are therefore that:
    a. The long term return expectation for the property portfolio should be 6.5% pa net of fees
    b. Aberdeen should be instructed to manage the main property portfolio as a 'Core' portfolio within their specified investment approach, with target asset category ranges as shown in table 1.
    c. Proceeds from sales of assets within the main property portfolio should continue to be re-invested in line with this strategy.
    d. Additional investment in property should be considered to bring the allocation closer to the strategic benchmark.

11. It is suggested that a further report is brought to the Pensions Sub-Committee in May 2014 regarding the final recommendation.

Statutory and Policy Implications

12. This report has been compiled after consideration of implications in respect of finance, the public sector equality duty, human resources, crime and disorder, human rights, the safeguarding of children, sustainability and the environment and those using the service and where such implications are material they are described below. Appropriate consultation has been undertaken and advice sought on these issues as required.

RECOMMENDATION/S

1) That the Nottinghamshire Pension Fund Committee be recommended to approve the following:
   a. The long term return expectation for the property portfolio should be 6.5% pa net of fees
   b. Aberdeen should be instructed to manage the main property portfolio as a 'Core' portfolio within their specified investment approach, with target asset category ranges as shown in table 1.
   c. Proceeds from sales of assets within the main property portfolio should continue to be re-invested in line with this strategy.

2. That a further report is brought to the Pensions Sub-Committee in May 2014 regarding possible additional investments in property.

Report Author:
Simon Cunnington
Senior Accountant – Pensions & Treasury Management

For any enquiries about this report please contact: Simon Cunnington

Background Papers and Published Documents

Except for previously published documents, which will be available elsewhere, the documents listed here will be available for inspection in accordance with Section 100D of the Local Government Act 1972.

Nottinghamshire County Council

Report to Pensions Working Party

27 January 2014

Agenda Item: 1

REPORT OF SERVICE DIRECTOR - FINANCE

PENSION FUND PROPERTY PORTFOLIO

Purpose of the Report

1. The main issue for the Working Party to discuss is the desired level of risk within the main property portfolio and consequently the target allocations within the different categories of assets. Discussions may be widened to cover the Fund's other property investments. The report presents background information on the Fund's property investments to inform these discussions.

Information and Advice

2. The Fund's agreed asset allocation ranges are currently:

Equities	55% to 75%
Property	5% to 25%
Bonds	10% to 25%
Cash	0% to 10%

3. The Fund's high level benchmarks are shown below together with the actual asset allocation of the Fund as at 30 September 2013.

Liability Based Benchmark	100.0%	FTSE UK Gilts IL > 5 Yrs	
Strategic Benchmark			**Actual 30/09/13**
Equities (inc private equity)	65.0%	FTSE All World	73%
Property	15.0%	IPD annual universe	12%
Bonds	17.5%	FTSE UK Gilt All Stock	13%
Cash	2.5%	LIBID 7 Day	2%
	100.0%		

4. The use of asset allocation ranges gives the Fund flexibility to decide on various management arrangements in order to balance risk management against the desire to outperform the strategic benchmark. According to the Statement of Investment Principles (SIP), the 'block of Bonds, Property and Cash is aimed at lowering overall risk (at the cost of anticipated lower return)'. The triennial valuation assumes that returns from property lie between those from equities and gilts and the long term assumption at the latest valuation is for returns of 6% pa.

5. A paper is attached from Aberdeen Asset Management, *'What can property offer an institutional investor?'*, which gives an overview of the characteristics, risks and returns available from property investing.

6. At 30 September 2013, the total exposure of the Fund to property was £409 million which is slightly below the strategic benchmark. The breakdown of the current exposure is shown below.

	£ millions	% of Fund
UK commercial property	281.4	
UK strategic land	11.4	
Aberdeen Portfolio	**292.8**	**8.3%**
Alpha UK Real Estate Fund	0.6	
Keills Property Trust	26.8	
Schroders UK Property Fund	4.1	
UK Pooled	**31.5**	**0.9%**
Aberdeen Dynamic European Property Fund of Funds	34.6	
Standard Life European Property Growth Fund	43.9	
Standard Life Global Real Estate IT	5.9	
Overseas Pooled	**84.4**	**2.4%**

7. The Fund has a significant portfolio of directly held UK commercial property which has been managed by Aberdeen Asset Management (albeit through a number of name changes and corporate ownerships) since 1990. This is a non-discretionary mandate, meaning that all decisions regarding the properties held (and potential purchases) are made by the Fund (on the basis of advice provided by Aberdeen) rather than by the manager.

8. The portfolio has traditionally favoured higher yielding properties requiring relatively intensive asset management. Returns have suffered since 2007 and Aberdeen have gradually been improving the quality of assets by recommending sales of more secondary assets and purchases of assets with longer, more durable income streams. This is in line with their investment approach outlined in the second attached paper from Aberdeen.

9. In 2009, Aberdeen were asked to look for opportunities to purchase strategic land for possible residential property use. To date, two direct holdings have been acquired and these are progressing through the planning process. In addition, the Fund has committed £15 million to the Barwood fund in which agreements are made with landowners to promote their land through the planning process. It is not envisaged that the Fund will take on construction risk, rather aiming to sell the land if planning consent is achieved.

10. The Alpha UK and Schroders funds were originally bought to gain property exposure for the separate (and much smaller) Admitted Bodies Fund. As with all non-prime property, performance of these funds has suffered over the last 5 years. The Keills Property Trust is a venture set up by the Fund's previous property manager and again has suffered recently. The trust is now focusing on acquiring properties where rentals are linked to inflation.

11. The overseas funds are largely focused on Europe and performance has been mixed. The Aberdeen Dynamic Fund of Funds has been the subject of much discussion recently and will be approaching the end of its life in the next 18 months to 2 years. This will result in the return of capital from the investment.

12. The main issue for the Working Party to discuss is the desired level of risk within the main property portfolio and consequently the target allocations within the different categories of assets. Aberdeen make recommendations within their report but also outline the possible impacts of adopting different targets.

13. It is also important to discuss the level of cash available for further investment by Aberdeen. Proceeds of property sales are assumed to be available for further purchases but this is at the discretion of the Fund. It is not recommended to reduce the allocation to Aberdeen but clarity over funds available for investment is needed. This should also include the strategic land initiative.

14. There has also been recent discussion of 'local' property investments and it was suggested at the last Investments Sub-Committee that this could be discussed at the Working Party.

15. Finally, it would be useful to consider the Fund's position as regards other property investment. The Fund is currently underweight its strategic benchmark allocation to property but this position has come about more from relative movements in valuations of different asset classes than from an active decision of the Fund.

16. It is therefore suggested that the Working Party makes recommendations on:
    a. The desired level of risk and target allocations within the Fund's main property portfolio
    b. The level of cash available to Aberdeen for additional investment
    c. Whether to consider local property investments
    d. Whether to make additional investments in property.

Statutory and Policy Implications

17. This report has been compiled after consideration of implications in respect of finance, the public sector equality duty, human resources, crime and disorder, human rights, the safeguarding of children, sustainability and the environment and those using the service and where such implications are material they are described below. Appropriate consultation has been undertaken and advice sought on these issues as required.

RECOMMENDATION/S

1. That the Working Party makes recommendations on:
    a. The desired level of risk and target allocations within the Fund's main property portfolio
    b. The level of cash available to Aberdeen for additional investment
    c. Whether to consider local property investments
    d. Whether to make additional investments in property.

Name of report author: **Simon Cunnington**
Title of report author: **Senior Accountant (Pensions & Treasury Management)**

For any enquiries about this report please contact: **Simon Cunnington**

What can property offer an institutional investor?

UK property investment briefing (Paper 1)

27 January 2014

What can property offer an institutional investor?

Contents

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3. Diversification of risk from other asset classes 4
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What can property offer an institutional investor?

Property can deliver a range of possible features and outcomes. In this paper we will describe features, question some of the accepted wisdoms regarding property investment and look at the potential outcomes in terms of volatility, inflation hedging, diversification, etc.

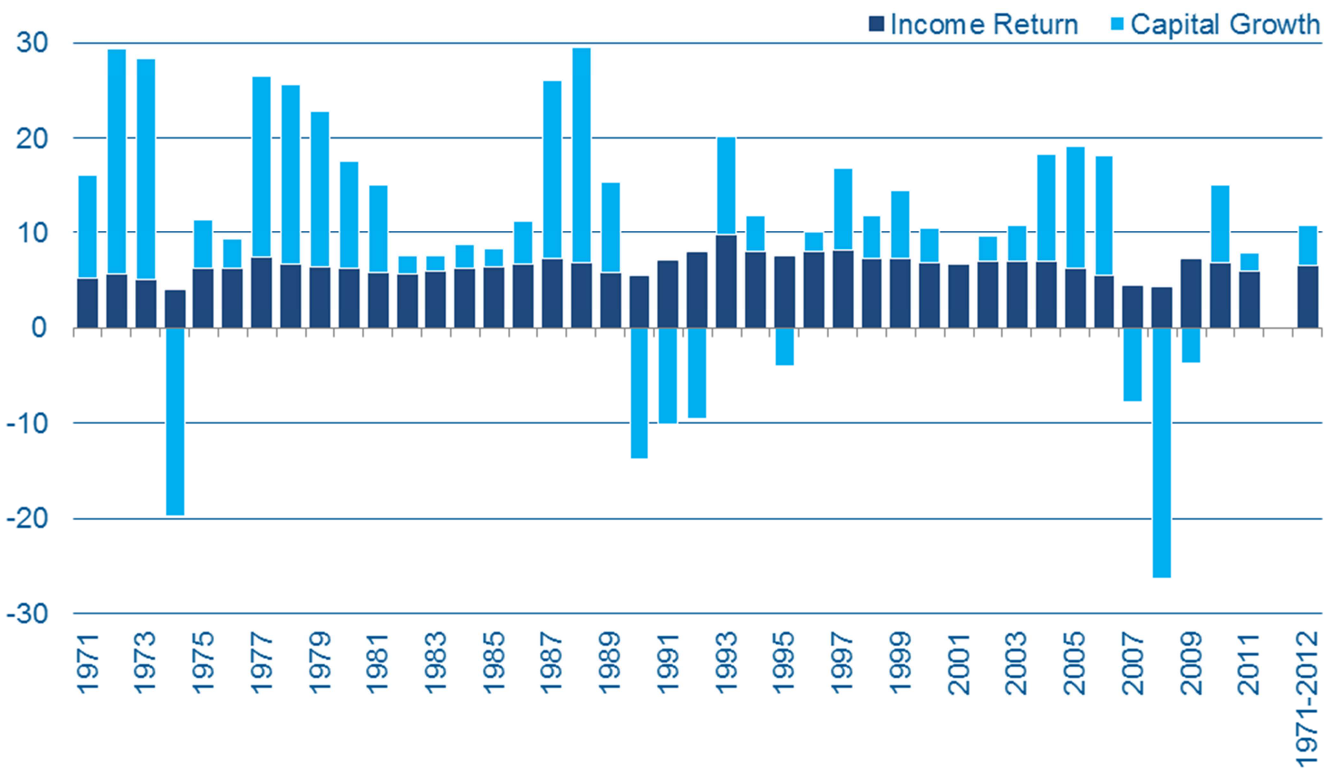
This paper outlines the features of direct property as an asset class. When investors think of property and describe its features as an asset class, they most often mean direct (assets directly owned by the investor), unleveraged property investment in the domestic market. It is important to emphasise that the characteristics of property investments that do not take the "purest", direct form are quite different. It is a common perception that indirect property (assets owned through a structure such as property unit trust) investment in property gives equally, or more, effective exposure to the underlying market. This paper will therefore conclude by highlighting why this perception is incorrect and demonstrate that the different "entry points" strongly influence the nature of the investment.

The key features of UK direct property investment

1. A relatively high and stable income return.

Over the long-term, direct property, as measured by the Investment Property Databank (IPD), has offered a relatively high and stable level of income return (yield) compared with UK bonds and equities. Chart 1, below, shows this feature back to 1971. IPD essentially represents a very large portfolio of property investments (measuring c£140 billion of mainly commercial property in the UK), giving sufficient diversification of income streams to show very little volatility. However, for most investors of any reasonable size it is not possible to replicate this stability in full.

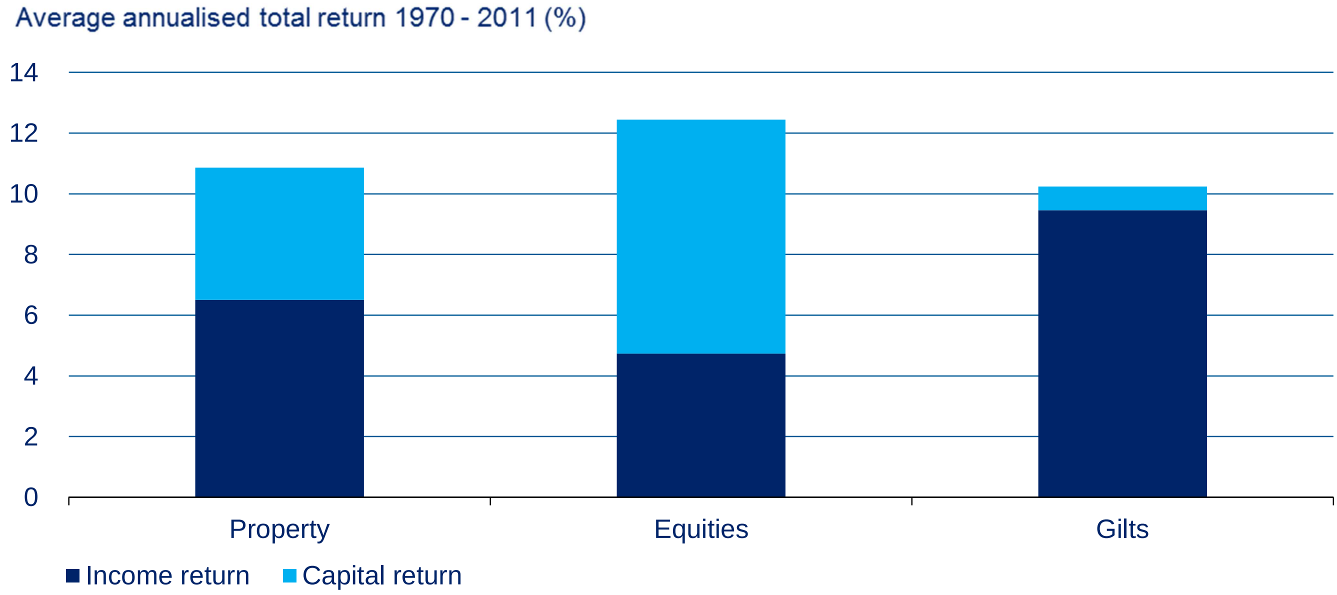
Chart 1: Income and capital returns, IPD Annual Universe, 1971 - 2012



Source: IPD, March 2013

Chart 2 shows that during the 42-year period since 1970, UK property has delivered an average annualised income return of 6.5%. This compares with an average income return on UK equities over the same period of 4.7%.

Chart 2: Property's income and capital return versus equities and gilts



Source: IPD, March 2013

In this way, property does tend to deliver a relatively high and stable level of income return.

2. Volatility

Property is sometimes argued to offer stable, low volatility, total returns. In the section above we have shown that the income component of property returns is indeed very stable, according to IPD data. While capital values have been more volatile, they have historically offered lower volatility than equities. However; in property, total return measures are based on values rather than prices and these two can be very different, whereas for equities they are the same.

Research has shown that because of the way that property index measures are built, from valuation data rather than by reference to market prices, they are smoothed: they appear less volatile than they actually are. The appearance of low volatility is inextricably linked to the degree of liquidity in property markets; an unwillingness to accept volatile prices leads to a lack of transactions where two parties can agree a price. Nevertheless, given property returns in the long-term should be based principally on the income stream generated and the growth of that income stream, if the market were rational it would offer very low volatility.

One aspect of returns that brings with it volatility is the ebb and flow of occupier markets, which directly impacts cash flows, where vacancy arises and further impacts the level of rent achievable at new lettings. It is poorer quality property that generally suffers more greatly from this volatility in demand. It is also the case that, due to easier substitution, rents and occupation rates in offices and industrial property have generally been more volatile than the retail sector and other consumer-facing property types.

However, in practice, due to sentiment and the swings in investment demand and supply, it is yield-based capital movements that contribute the majority of volatility in property returns, as demonstrated in Chart 1 above.

So, whilst property appears to have relatively low volatility it is worth remembering that some of this is because the index measures valuation movements and not price movements.

3. Diversification of risk from other asset classes

Valuation smoothing of property indices not only alters the volatility of property indices but also adds a lag to the indices. This means that whilst correlations with other asset classes appear relatively low (see Chart 3), they would be higher were the index measures to be based on prices. Furthermore, even with that lag, the property market has exhibited a much closer relationship with equities over recent years, with both being severely impacted by the financial crisis. The high degree of leverage through bank loans that built up throughout the 2000s ensured that property markets were inextricably linked to the banking crisis. Property lost over 40% of its value in the period 2007-2009.

Chart 3: Correlation of UK property total returns with UK equities and gilts 1970 - 2011

	Property	Equities	Gilts
Property	1		
Equities	0.28	1	
Gilts	0.03	0.56	1

Source: IPD, Aberdeen Asset Management, Jan 14

As a property's value is based on its ability to generate a rental income stream (and the factors that influence that ability are rooted in the economic environment and the activities of businesses that contribute to the economy) you would expect some correlation with the value, through share prices, of those companies that are direct tenants. However, the relative length of lease under which a tenant occupies a building is crucial to breaking down the correlation and giving some diversification from other asset classes. Unless the tenant defaults, it should continue paying the rent and therefore the value of the property is unaffected, or at least less affected, than the valuation of the company. The income return will remain the same or increase; the capital value may fall as yields correct to reflect the strength of covenant offered.

Property does offer diversification of risk against other asset classes though the benefits are less strong than they first appear.

4. Liquidity

Property is usually described as an illiquid asset class. A liquid asset is one that can be converted into cash very quickly and vice versa, such as listed stocks. An asset which is illiquid takes longer to exchange and so during that period there is a risk that prices fall; this means that investors demand an "illiquidity premium" from property. There are in fact two sources of illiquidity in property, one of which is true illiquidity and the other which is not.

The first, true source of illiquidity is the time which it takes to trade due to the due diligence involved in assessing the quality of the investment. In normal markets this is typically two to three months, but can be longer in weaker markets or more complex transactions.

The second source of illiquidity is self-imposed: it is the lack of willingness on behalf of the buyer or seller to buy or sell at market prices. Investors tend to anchor their expectation of price around recent market evidence or valuations and are often unwilling to accept if they wish to trade then they need to do so at the market price. Being unwilling to sell at a price below valuation is not a source of illiquidity, nor is being unwilling to pay the market price to buy a property.

In this way, property can be more liquid than it appears, as long as an investor is willing to buy or sell at market prices. However, this makes property more volatile than it first appears. Liquidity and volatility are two sides of the same coin.

5. Inflation hedging

Many investors view property as an inflation hedge. An asset is an inflation hedge if its returns are protected against inflation risk (expected and unexpected inflation), that is, the returns tend to move, both in terms of timing and in terms of level, to match or exceed inflation.

Inflation hedges are not:

1) assets that deliver a positive real (net of inflation) return and/or

2) assets where the returns have a high correlation with actual inflation

So is property an inflation hedge? Our analysis has shown that, on average, UK commercial property has not been an inflation hedge. However, the picture is more complex than this and if you disaggregate the property market, it is possible to find individual markets or types of assets which better satisfy the requirements of being an inflation hedge. Some assets, such as supermarkets, have long leases where the growth of rental income is tied to inflation. However, the rental income uplifts are usually subject to 'caps' and 'collars', hence income growth may not fully reflect inflation if inflation is high (typically above four to five per cent). In addition, while the income is linked to inflation, the capital value is not.

We believe that the best way to ensure that property does provide an inflation hedge is to invest in parts of the market where the market rental growth is likely to be higher than inflation in the long term. This means identifying types and locations of assets that offer an element of structural undersupply. This occurs where "monopolies" exist. For instance, in some cases it is not possible to substitute one location for another; transport nodes are a good example of natural location monopolies. Other examples include locations where the planning system creates a locational advantage in so far as it is not possible to create new space which is a substitute for the existing space.

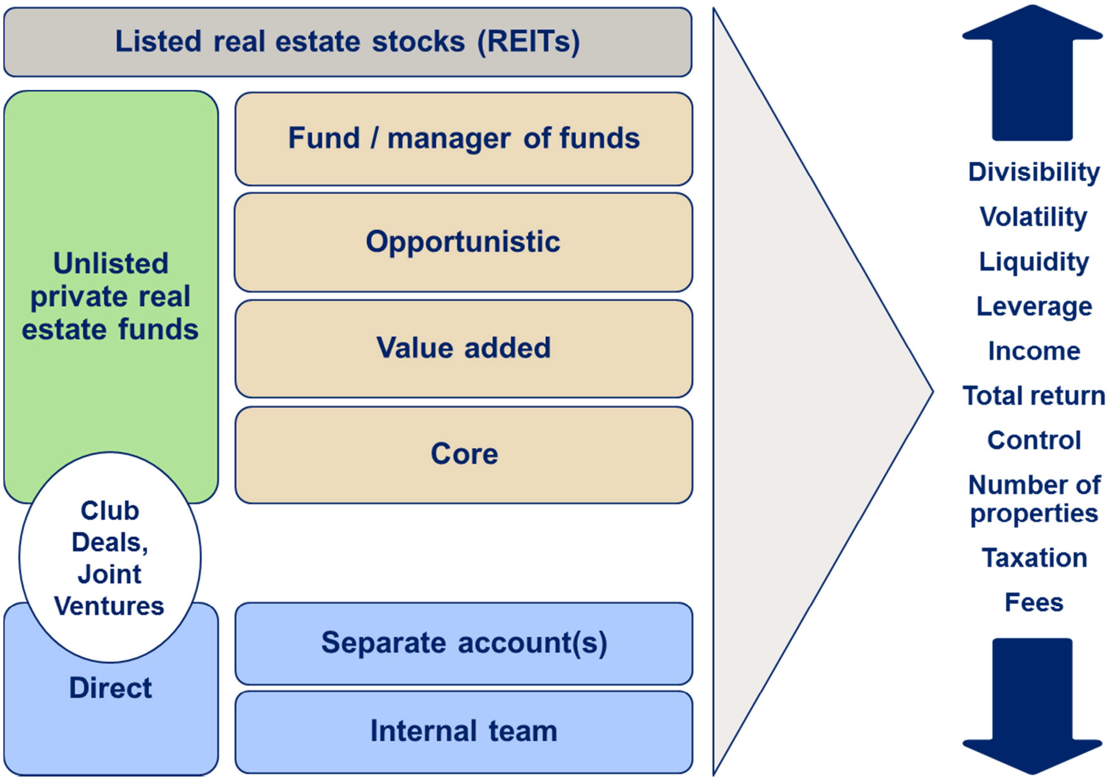
Investing broadly into "property" expecting to receive an inflation hedge is likely to lead to disappointment; if inflation hedging is a requirement then the property portfolio needs to be biased towards certain types and locations and away from others.

Property: routes to entry

We conclude this paper by commenting briefly on the main routes to investing in property (see Chart 4). So far we have only focussed on the features of property as a direct investment.

- **Direct property**: offers a high degree of control with the potential of high income returns with low return volatility over the long term. Divisibility is low because of large lot sizes which makes assembly of a diversified portfolio very difficult.

Chart 4: Property routes to entry



Source: Aberdeen Asset Management, Jan 14

Other routes provide a trade-off across a number of attributes shown in the right of Chart 4:

- **Listed property companies and Real Estate Investment Trusts (REITs):** are highly liquid and divisible with low fees, but offer little control to investors. Pricing can diverge significantly from underlying property valuations due to wider stock market influences. The underlying assets of REITs tend to be predominately income producing and relatively low risk, but the use of leverage pushes up risk. Other property companies, such as developers, are more risky due to a relatively low proportion of income earning assets on their balance sheet.
- **Unlisted funds:** provide a balance between direct property and REITs. Unlisted funds have divisibility and moderate volatility in the case of core funds. Investors can sometimes assert a level of control but this is usually limited to expressing a view to the manager. Core fund assets are predominately income producing, but the opposite is true for more risky value-add/opportunistic strategies which tend to take on vacancy risk or development activities. Risk is increased by the use of leverage which is applied across many funds.

The most appropriate investment route depends upon the objective of the investor.

A low risk multi-asset investor should be attracted to low volatility, which is a key attribute of unleveraged direct assets; whereas the volatility of unlisted funds can vary depending upon the type of strategy. The volatility of listed property stands out as it can be very high due to the application of leverage and the public pricing of shares. Large investors taking their first step into property are likely to favour direct investment to benefit from its low risk characteristics and to achieve stronger risk-adjusted returns at the multi-asset level.

6. Conclusion

Direct, unleveraged, UK property can offer institutional investors a number of positive features:

- Property's income return is relatively stable
- Property's volatility is likely to be lower than that for equities but not as low as it appears if/when liquidity is required (when prices must be experienced)
- Property does act as a diversifier against the risk of other asset classes but the benefits are not as strong as they first appear if/when liquidity is required (when prices must be experienced)
- Property is more liquid than it first appears but investors will need to tolerate greater volatility to achieve that liquidity
- Property is not, on average, an inflation hedge. Those seeking inflation hedging characteristics from property need to be selective in the types and locations of assets which they buy and hold

Alternative routes to entry do not offer the same features. Trade-offs are necessary which compromise the main features of direct property investment but may offer enhancements in other ways.

Aberdeen's view on direct property investment related to local government pension schemes (LGPS)

Aberdeen has four LGPS clients. It is our view that investment in direct UK property is the most efficient way to access property for those able to commit more than £150m to the asset class. At this size it is possible to build a direct property portfolio of 20 to 30 assets which offer the key attributes which our clients consider important. Typically property is included in the multi-asset portfolio for the key features of delivering:

- Stable income returns
- Relatively low volatility (given a long-term time horizon for investment)
- Diversification against other asset classes' risks
- Access to an illiquidity premium, which other shorter-term investors in the asset class require, and
- Some notion of inflation hedging

It is perhaps the liquidity/volatility and inflation hedging features that create the biggest level of confusion for investors.

For those able to commit around £500m to property, it is possible to combine UK direct property investment with a global (excluding UK) portfolio of core unlisted funds. We believe that this offers increased risk adjusted returns in the long term. We would typically recommend an allocation of around 30% of that £500m to global ex UK property.

Nottinghamshire County Council Pension Fund

UK property investment briefing (Paper 2)

27 January 2014

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Property can deliver a range of possible features and outcomes. In the two papers presented here we will describe these features, question some of the accepted wisdoms regarding property investment and look at the potential outcomes.

The paper titled “What can property offer an institutional investor” outlines the features of property as an asset class and also some of the features that certain types of property assets may offer.

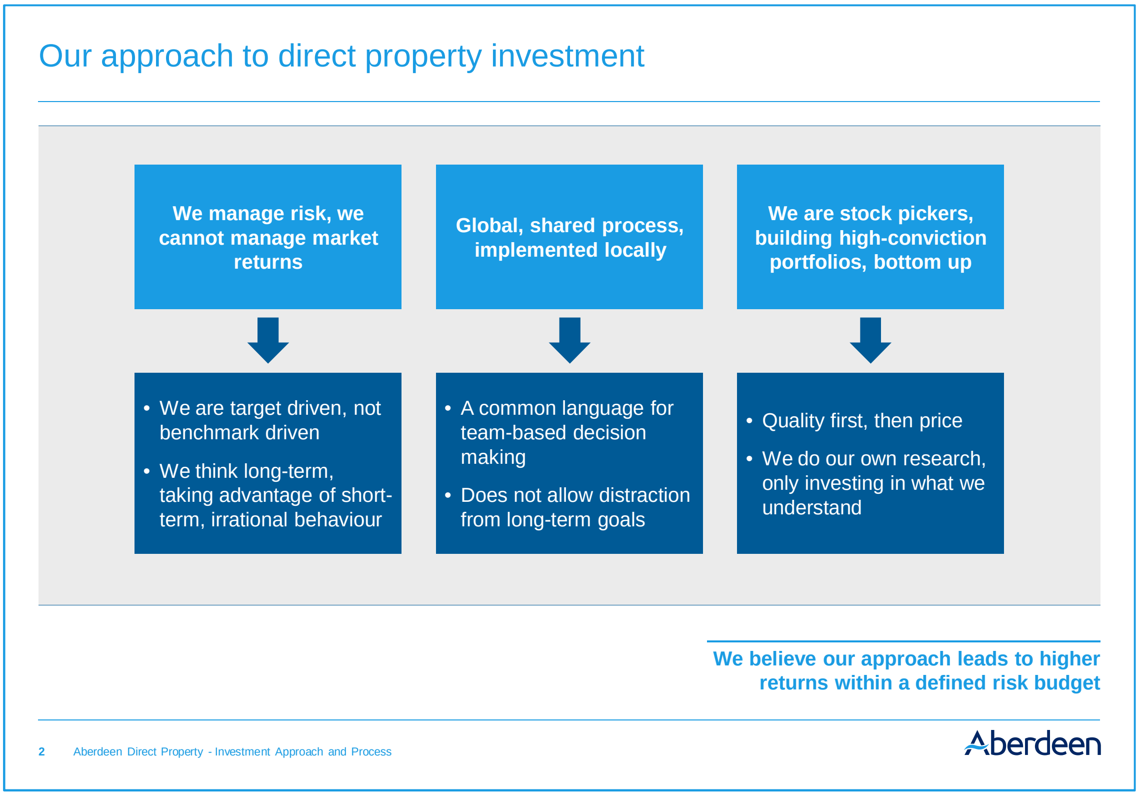
This paper will set out how the Aberdeen process seeks to secure the best long term returns for our clients, offering the lowest risk and volatility and how we would suggest this is specifically applied to the Pension Fund, in line with its stated strategic aims for property within a multi-asset portfolio. Finally, we will set out two different risk profiles that could be adopted by the Pension Fund and specify the risks inherent in each.

The Aberdeen process

Having established the theoretical arguments for property in “What can property offer an institutional investor”, we now explain how the Aberdeen process is designed to take advantage of some of the misconceptions regarding property and how it seeks to exploit market mispricing arising from those misconceptions.

The approach to investment in property reflects the general approach that Aberdeen adopts across all asset classes but is adapted for the particular needs of property. At its core are the following aspects:

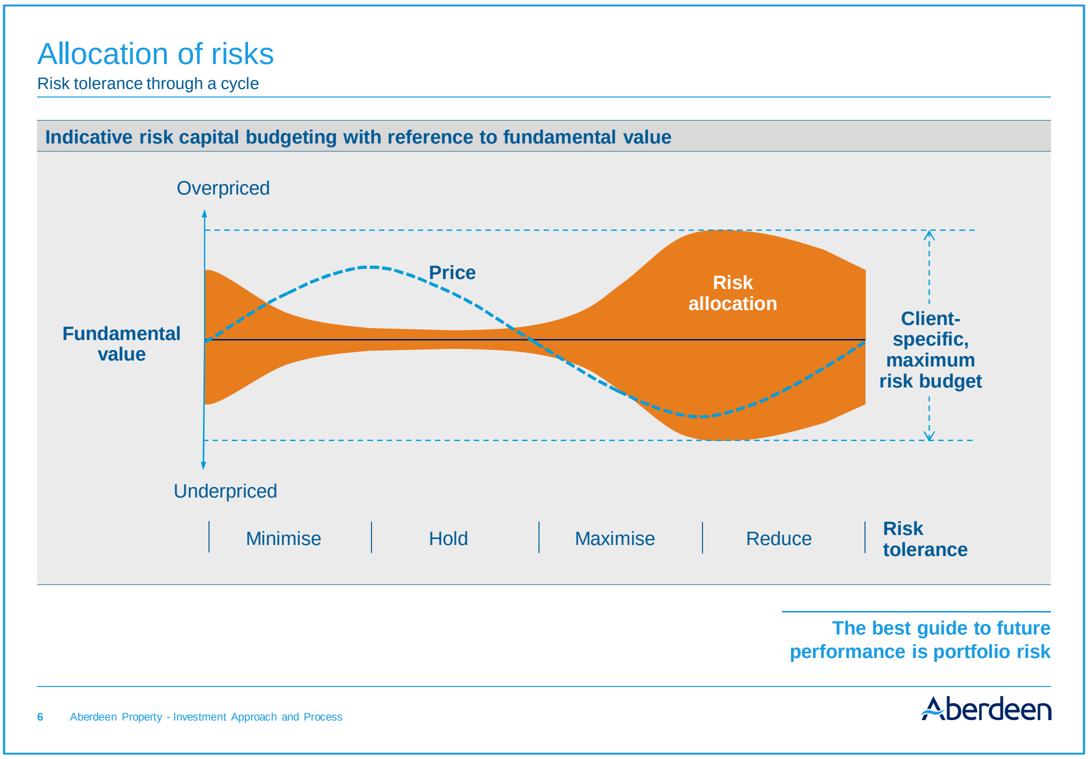
- We can manage risk, we cannot manage market returns
- We follow a process which does not allow distraction from long-term goals
- We build high-conviction portfolios, bottom up
- We invest on the basis of quality first, then price
- We believe that our approach will lead our investors to earn higher returns, within a defined risk budget, in the longer term.



Accordingly, we recognise that:

- Risk can be consistently mispriced by the market
- By adopting an absolute value approach to investment, our investors will be rewarded when we hold the right types of risks at the right point in the property cycle
- A focus on short-term return seeking or benchmark-based decisions is likely to lead to style drift and deliver inferior longer term outcomes

At the core of our processes are the concepts of risk tolerance and risk budgeting and their use to define the extent of the risks which should be taken at different points in the cycle, within the context of our clients' objectives. This can be broadly described within a framework of dynamic risk allocation and is summarised in the diagram below.



Aberdeen favours a style that provides a consistent, secure income stream; a policy of buying/selling risk when it is being consistently mispriced by the market; a policy of buying and holding long term with limited trading; avoiding assets that will show higher than average volatility in capital returns: and seeking assets which can provide a degree of hedging against inflation.

This is represented as a policy of quality first, then price.

In our analysis, when buying, selling or holding assets, we will calculate the long term fundamental value of each asset compared to the market price or latest valuation. The discrepancy between price and fundamental value is a strong indication of whether we buy, hold or sell that asset.

Quality is defined as the ability for a property to deliver a durable income stream with the potential for growth. Factors influencing this are shown in the following chart. We do not define quality as a brand new building in a prime location. Properties must be fit for purpose in their market and be able to generate a durable income stream with the potential for the long term growth of that income.

What is quality?

Durability (of income and building)

- Ability to deliver income over a long period
  - Long lease
  - Series of shorter leases
  - Minimal downtime / void
- Low obsolescence risk
  - Functional
  - Physical
  - Economic
  - Social

Long-term growth

- Derived from a long-term mismatch between supply and demand
- Supply restricted
  - Institutional support
    - Planning/zoning system
  - Locational support
    - Monopoly locations
- Demand push
  - Demographic
  - Consumption and Production Trends

We do our own research, only investing in what we understand

16 Aberdeen Property - Investment Approach and Process

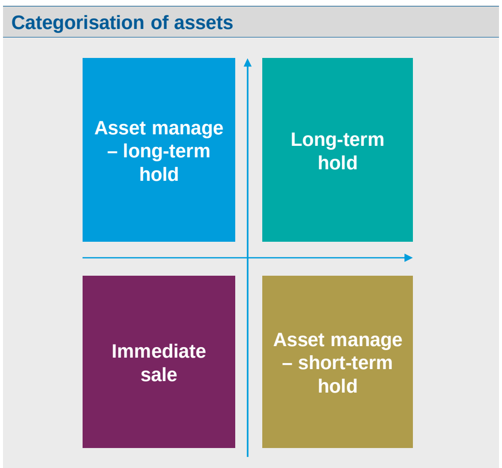
Aberdeen

Over time, good quality, low risk assets should show less volatility, should not suffer as much in a downturn and should recover more quickly in the upturn.

Application of the process to the Pension Fund

At purchase and throughout ownership, assets are categorised according to the schedule in the following chart. This broad categorisation allows us to design and monitor the "shape" of the portfolio.

How we manage a direct property portfolio



Long-term hold (5 years +)

- Held regardless of market environment or potential short-term relative performance
- Focus on quality
  - Durable income
  - Potential for growth

Asset manage – long-term hold

- Manufacture of long-term hold assets
- Adding value to core assets

Asset manage – short-term hold

- Tactical, value-added strategy for assets not to be held in the long term
- Assets requiring asset management prior to sale

Immediate sales

- Assets no longer fulfilling a strategic or tactical role in the portfolio
- Sale possible now at a price which realises the value of unexploited opportunities

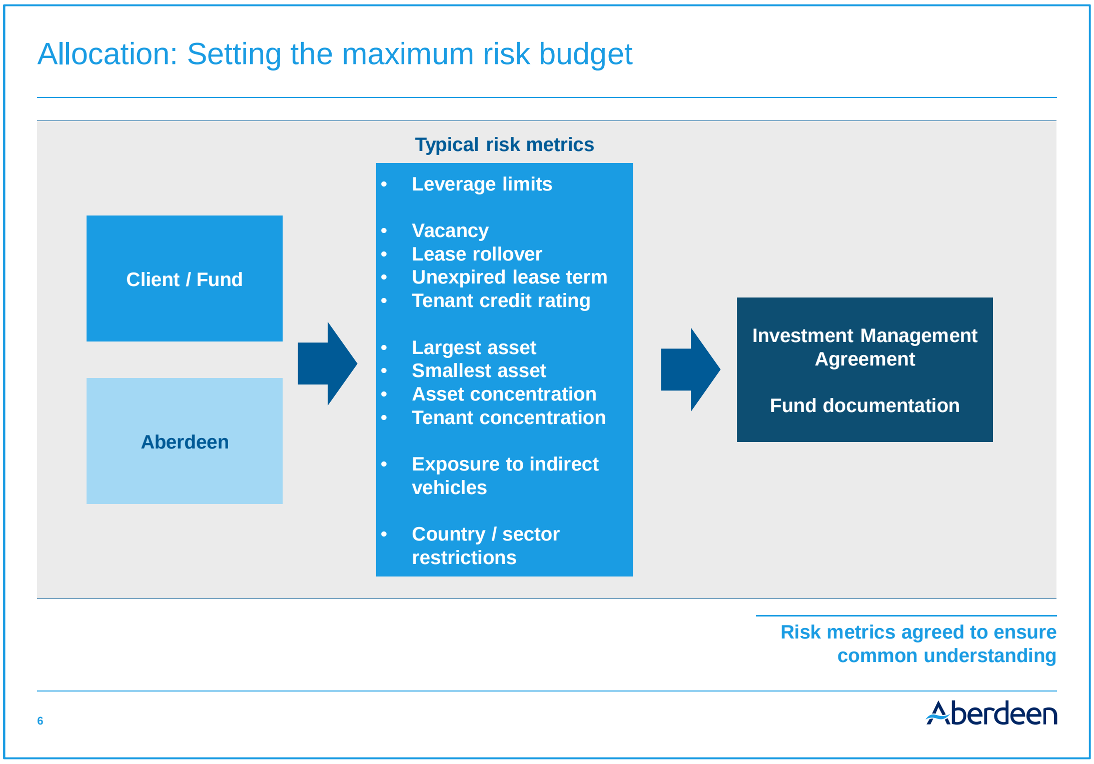
We do our own research, only investing in what we understand

15 Aberdeen Property - Investment Approach and Process

Aberdeen

The relative percentage held in each category is determined by the Fund's risk profile. A fund with a low threshold to risk would hold a higher percentage in Long Term Hold ("LTH") assets, whilst one which was happy to take on a higher level of risk (in a value-add style portfolio) would hold a higher percentage of its assets in the Asset Manage Short Term Hold ("AMSTH") or Immediate Sale ("IS") categories.

Beyond the broad "shape" of the portfolio we typically apply limits to the portfolio to control risk. These are client specific and ensure that we are managing within a risk budget at all times, ensuring no surprises for the client and a well-understood framework for us to operate within. The types of risks we typically consider are laid out in the chart below.



Alternative structures

Our investment process is designed to consistently meet our clients' objectives. Whilst these may be set out in terms of a required return, it is our role to explain, communicate and manage the risks that we believe are commensurate with such a return objective. It is therefore paramount that we understand our clients' objectives and tolerance for risk before implementing our investment process. The actual target ranges adopted for each quadrant therefore need to be determined following discussion with the Fund Trustees to reflect their preferred risk tolerance.

To facilitate that discussion, indicative ranges for "value-add" and "core" portfolio structures are set out in the table below:

Categorisation	Value-add	Core
Long term hold	0%	50 - 70%
Asset manage long term hold	0%	10 - 20%
Asset manage short term hold	60 - 70%	0 - 20%
Immediate sale	20 - 30%	0 - 10%

The percentage ranges are used as a guide to help identify risk in the portfolio and are not intended to be absolute targets, although we would normally aim for 70 to 100% above the line in the LTH/AMLTH categories. This would leave 0 to 30%in asset management/sale assets. At different points in the cycle we would aim to move the shape of the portfolio to the higher or lower end of these ranges to reflect the opportunities presented by periods of over or under-pricing. This would only be done following consultation with the Fund.

The risks/rewards of holding a specific style of portfolio are set out below.

Existing/potential shape of the portfolio

It has always been understood that the Fund held property for its income characteristics, in a block of assets alongside the Fund's fixed income holdings. This has historically been interpreted as a desire to see a higher yield from the property portfolio than the property market delivers on average. This led to a propensity to acquire and hold more asset management style properties - either more secondary properties or those requiring active management to drive performance. The issue now is whether the Fund should shift from an emphasis on higher yield to one of more sustainable, durable income?

By way of illustration and to assist deliberation, we set out in the table below the relative percentages in the Fund at three different stages, categorised into the four quadrants described above. These stages are:

(1) As the Fund was in June 2008,

(2) As it was in December 2013, and

(3) How it could look, once we have completed the current round of sales and re-invested the proceeds

Categorisation	June 2008	December 2013	On completion of sales/purchases – end 2014
Long term hold	27%	41%	52%
Asset manage long term hold	23%	25%	31%
Asset manage short term hold	37%	16%	8%
Immediate sale	13%	18%	6%

The position as at June 2008 has been categorised based on a review of what transactions were actually being undertaken at the time. We have tried to avoid applying hindsight to this process so the resultant numbers should provide a good indication of how the portfolio might have looked in 2008 had it been categorised using the current Aberdeen process. The final position at end-2014 assumes all current sales complete, all monies are reinvested and the next round of potential sales (currently in the AMSTH category) are identified.

This analysis shows that in June 2008 the portfolio contained a high percentage of properties "below the line" in the AMSTH or Immediate Sale categories, at roughly 50% and with only 27% in the LTH category. This reflected the prevailing view that higher yielding stock should be targeted. Although not a value-add structure it was quite a way from being a core portfolio.

On the same analysis, the portfolio as it is today is in transition and by the end of 2014 it could be classified as a "core" portfolio, sitting close to the ranges outlined above.

Risks/rewards in adopting the Value add structure

A portfolio with this type of structure will have all its assets categorised below the line in AMSTH or Immediate sale. Such assets will tend to be assets displaying one or more of the following characteristics and by their nature, will be assets offering short term management opportunities which can be exploited and then sold:

- Poor quality location – this will make them more susceptible to voids in a weak occupier market or to changes in supply.
- Poorer, less flexible accommodation – this may require more than anticipated capital expenditure to ensure durability of income
- Shorter average lease length – potentially more voids and exposure to non-recoverable income will be experienced
- Lower quality tenant covenants - exposure to potential tenant failure
- Assets which could be sold immediately at a price which realises the value of unexploited opportunities – properties assessed as being over-priced by the Aberdeen process and which can be exited at a premium over our assessment of fundamental value
- A propensity to trade more than average, resulting in higher transaction costs and incurring a "round trip" of around 8% each time an asset is sold and those monies reinvested

In summary, assets offering opportunities for short term gain but which are generally not able to offer durable income over a longer time horizon.

This type of asset can perform well in a rising market when risk is more accepted by investors and yields are being compressed in favour of such stock. The Fund historically held a higher proportion of buildings of this type and over the period 2002 to 2007 saw returns of 0.6% per annum in excess of the IPD Benchmark. However, in a downturn this type of asset will tend to be the first to lose value as investors retreat into defensive assets; they will tend to lose more value overall; and will take longer to recover. Again, by reference to the Pension Fund's own assets, for the five years to September 2013, the Fund has underperformed -0.9% per annum relative to the Benchmark due to its greater exposure to higher risk stock over this period.

In holding a portfolio with this type of structure, an investor will require to be compensated for the risks in so doing. The Aberdeen process would advise that this is generally not achievable over the long term.

Risks/rewards in adopting a Core structure

This style of portfolio will hold a higher percentage of assets in the LTH/AMLTH categories. These assets will generally display more than one of the following characteristics:

- Good quality location for an asset of its type – where demand for such an asset is likely to be strongest in the long term and one which will not be challenged by a change in supply or prime location or through social or economic factors
- Flexible accommodation – good quality buildings which will require minimal capital expenditure to retain income or which could be adapted to alternative uses
- Durable income – this can come from either a long lease or a series of shorter leases. Provided location and quality of building are sufficiently good, the ability to re-let space with minimal void exposure should be improved
- Better quality tenant covenant – less exposure to tenant failure and consequent void costs
- A lease structure offering fixed rental uplifts either by reference to a set percentage or to changes in CPI/RPI. These will provide secure, predictable income streams, often at levels of growth not achievable through the open market rent review mechanism

In summary, assets which are able to deliver durable income over the long term. It is Aberdeen's view that a portfolio adopting this style will earn higher returns, within a defined risk budget, in the longer term.

During periods of yield compression, a low risk portfolio will be likely to underperform as investors favour more risky assets. This will force yields on such assets down whilst ignoring lower risk properties, which are already yielding a lower income return. However, when the market cycle turns, it is Aberdeen's view that lower risk, more defensive stock will retain more value and will recover more quickly than higher yielding stock. The degree of outperformance at this stage in the cycle will generally more than compensate for the relative underperformance during the yield compression stage, thus providing a higher overall return over a long term cycle. This can be achieved whilst exposing the Fund to a lower degree of overall risk.

What should a core direct property portfolio look like?

Given the Pension Fund has a long term target to achieve a property return from the portfolio, we would recommend that the Fund should target the "core" portfolio ranges set out above.

With reference to the previous charts, we believe that a core direct property portfolio should have the following characteristics:

- Around 25 to 35 assets: sufficient to reduce risk in the fund but a manageable number where each asset can meaningfully contribute to the performance of the portfolio
- Low vacancy < 10% of estimated rental value
- Relatively long leases, averaging towards 10 years
- The largest asset not to represent more than 10% by value of the portfolio and the smallest not less than 2% (unless minimal asset management activity is required e.g. a long let supermarket)
- Good quality tenants
- An explicit degree of exposure to inflation index-linked leases
- No restrictions on location or sector. Good quality assets which will satisfy the fund's aims are not restricted to certain sectors or locations

- No UK indirect investment: we believe that a typical pension fund target can be met through direct ownership of assets so long as the fund is able to commit over £150m

Conclusion

From the two papers presented here, we would suggest the following lessons are relevant for the Pension Fund's portfolio:

(1) Property can offer a high and stable income return relative to other asset classes. The Aberdeen process favours holding a high percentage of core assets, those which can deliver a stable, durable income over the long term to capture this return.

(2) The capital return is much more volatile. Higher levels of volatility can be avoided by holding good quality assets. Such assets tend to offer lower volatility over the long term.

(3) The capital and total return from property have been less volatile than equities returns historically.

(4) Property can provide a degree of diversification to equities or bonds

(5) Property generally has not been an inflation hedge, but certain parts of the property market can be. Investment in properties with rent review mechanisms offering fixed increases or increases indexed to changes in the CPI/RPI can offer a degree of protection against inflation.

(6) The Aberdeen approach to investment in property reflects the general approach that Aberdeen adopts across all asset classes. The principles outlined in this paper are all designed to ensure we follow a process which does not allow distraction from long-term goals and that we invest on the basis of quality first, then price. As we can manage risk, but cannot manage market returns we must ensure that the client's approach to risk is understood and properly reflected in the structure of their portfolios.

(7) We believe that the Pension Fund should target a core portfolio structure, in line with the principles outlined in this paper.

We believe that application of this approach will lead the Pension Fund to earn higher returns, within a defined risk budget, in the longer term.

Nottinghamshire County Council

Report to Pensions Sub-Committee

06 February 2014

Agenda Item:8

REPORT OF SERVICE DIRECTOR – FINANCE & PROCUREMENT

TRIENNIAL VALUATION – INITIAL RESULTS

Purpose of the Report

1. To inform members of the initial results of the triennial valuation of the Fund as at 31 March 2013.

Information and Advice

2. The Fund is required to obtain an actuarial valuation of the assets and liabilities of the Fund every three years in order to determine the contributions payable by each employer. The actuary issues a rates and adjustments certificate specifying the common rate of employer's contribution and any individual adjustments to take account of circumstances particular to each employer. These circumstances include the different membership profiles of each employer and the level of assessed deficit of liabilities over assets.

3. The rates and adjustments certificate covers the three years following the year in which the valuation is prepared. The latest triennial valuation of the Fund was required as at 31 March 2013 with rates being certified for years 2014/15 to 2016/17. Initial whole fund results have now been received although the valuation will not be finalised until the end of March 2014.

4. In order to carry out the valuation, the actuaries require detailed information about the membership of the fund and the investments. This information is used to estimate the cash flows in relation to each member. The actuaries have made assumptions over pay increases, inflation, life expectancy and the new scheme in order to come up with this estimate. Further assumptions are used (mainly in respect of expected investment returns) to determine a 'discount rate' which is then used to discount the cash flows to estimate the total of the Fund's liabilities.

5. The basic premise of the discount rate is that investment returns can help to cover liabilities in the future – if the Fund has £100 now and can expect investment returns of 5% pa then that £100 is sufficient to cover £105 of liabilities in 1 year's time. Hence the liability figure (in this example £105) is 'discounted' back to the present value (£100) using the assumed rate of investment return. The actuaries therefore look at the asset allocation of the Fund and the expected long term returns of each asset class in deciding the appropriate discount rate. It is important to note that a higher discount rate produces a lower liability figure (and vice versa).

6. Under the LGPS governing regulations, the actuaries are required to have regard to the 'desirability of maintaining as nearly constant a common rate as possible'. However, they also have a professional duty to ensure the assumptions made at the valuation are

reasonable. Increasingly, these assumptions will come under scrutiny from the Treasury and potentially the Pensions Regulator.

7. The agreed financial assumptions used in the latest valuation are shown below along with comparisons from the previous valuation.

Financial Assumptions		31/03/13		31/03/10
Central Discount Rate		6.0%		6.9%
Pay Increases:	Long term	4.5%		5.0%
	Short term	2.7%	for those over £21k	0.0%
Retail Price Inflation		3.5%		3.5%
Pension Increases (CPI)		2.7%		3.0%

8. As can be seen, the discount rate has reduced thus increasing liabilities, although the increase is mitigated slightly by assumptions over pay and pension increases. Initial results for the Fund show liabilities of £4,090 million compared to assets of £3,470 million, giving a funding level of 85%. This is up slightly from 84% at 2010, mainly owing to the investment performance over the period (8.2% pa against the assumed rate of 6.9%).

9. Further discussions will be held with the actuaries and the major employers within the Fund in order to finalise the results. The final valuation report will be brought to a future meeting of the Sub-Committee.

Statutory and Policy Implications

10. This report has been compiled after consideration of implications in respect of finance, the public sector equality duty, human resources, crime and disorder, human rights, the safeguarding of children, sustainability and the environment and those using the service and where such implications are material they are described below. Appropriate consultation has been undertaken and advice sought on these issues as required.

RECOMMENDATION/S

1) That the report be noted.

Report Author:
Simon Cunnington
Senior Accountant – Pensions & Treasury Management

For any enquiries about this report please contact: Simon Cunnington

Background Papers and Published Documents

Except for previously published documents, which will be available elsewhere, the documents listed here will be available for inspection in accordance with Section 100D of the Local Government Act 1972.

Nottinghamshire County Council

Report to Pensions Sub-Committee

06 February 2014

Agenda Item:9

REPORT OF SERVICE DIRECTOR – FINANCE & PROCUREMENT

OPERATION OF THE IN HOUSE TEAM AND PORTFOLIO

Purpose of the Report

1. To inform members of the operations of the Pensions & Treasury Management Team and the In-House Portfolio.

Information and Advice

2. The Pensions & Treasury Management Team is responsible for the administration of the pension fund investments, the accounting for the whole fund and cash management for both the pension fund and the County Council. The Team comprises six members of staff:
    - Senior Accountant (Pensions & Treasury Management)
    - Investments Officer
    - 2 Accountants
    - Loans Officer
    - Finance Assistant

3. The main responsibilities of the team are specified in the service plan, relevant extracts of which were reported to the Nottinghamshire Pension Fund Committee on 18 April 2013. In relation to the pension fund, these responsibilities are:

    - Management of the In-house investments
    - Producing the statement of accounts and annual report
    - Quarterly valuation and reporting to Pensions Investment Sub-Committee
    - Advice and support to Committees
    - Co-ordinating IAS19/FRS17 reports for fund employers
    - Triennial Valuation of the Fund

    Further detail is given in the following paragraphs.

4. About 40% of the Fund is invested in equities within the in-house portfolio. This currently equates to about £1.4 billion. In addition, sterling cash balances for the whole fund (currently around £100 million) are managed in-house. The In-house equities are managed on an ‘enhanced consensus indexation’ basis. This is best explained in reverse order.

Indexation	The portfolio is largely invested passively, aiming to track a combined benchmark of market indices
Consensus	The benchmark weightings are based on the WM local authority average asset allocations
Enhanced	The portfolio has a small outperformance target. This is achieved through taking small over and under-weight positions and through having some actively managed pooled funds (mainly in the smaller overseas markets).

5. Individual direct shares are held in the UK, Europe and US markets. These portfolios are managed using BarraOne software which enables the monitoring of active risk compared to the benchmark. Trading decisions are based on information from BarraOne and brokers as well as general market and economic data. The aim in trading is to capture outperformance against the benchmark and reduce underperformance.

6. Legal & General index tracker funds and some actively managed pooled funds are used to invest in 'small cap' companies and to access other overseas markets. The majority of the pooled funds have been held for a number of years. Quarterly reports are taken to the Pensions Investment Sub-Committee on the value and activity within the portfolio and the latest reported position is shown below for information.

	30 September 2013 Portfolio		30 June 2013 Portfolio		Average
	£000	**%**	**£000**	**%**	**%**
UK Equities	620,694	44.3%	595,601	44.0%	41.8%
Overseas Equities:	724,295	51.7%	712,324	52.7%	57.7%
North America	264,101	18.9%	268,326	19.8%	20.9%
Europe	169,564	12.1%	155,038	11.5%	14.4%
Japan	67,571	4.8%	67,397	5.0%	6.4%
Pacific Basin	94,874	6.8%	91,001	6.7%	5.9%
Emerging Markets	128,185	9.2%	130,562	9.7%	10.1%
Cash	55,312	4.0%	44,743	3.3%	0.5%
Total	**1,400,301**		**1,352,668**		

The average fund figures are from the WM Local Authority universe.

7. The directly held shares are 'custodied' by the pension fund's custodian, State Street. These are held in electronic form, enabling transactions to be carried out quickly and efficiently. State Street also have custody of the assets within the Schroders and Kames portfolios.

8. All the assets of the Fund are recorded within a specialist investment management system, Shareholder. The team uses this system to record all purchases, sales, capital expenditure, corporate actions and investment income. Each quarter, the records within Shareholder are reconciled to the various managers' records as well as the Custodian records where appropriate. This enables detailed holding and transaction reports to be given to the Pensions Investment Sub-Committee each quarter for the in-house portfolio and summary data to be provided on the other Fund portfolios. This system also provides the data to be submitted to the WM Company for performance reporting purposes and provides the basis for the net assets statement included within the annual accounts.

9. The statement of accounts is one of the key outputs of the team. It is a statutory requirement and is prepared on the basis of accounting guidance from CIPFA. There are tight deadlines for publication of the accounts and so the process is carefully managed. The pension fund annual report is a regulatory requirement and is produced by the team well ahead of the required deadline in order to be available for external audit and the Fund's annual meeting. The team also provides information on borrowing and cash investments to feed into the County Council accounts. A summary of the treasury management activity for 2012/13 is provided below.

County Council Treasury Management Activity 2012/13

Total outstanding borrowing	£319.8m
Total cash invested	£798.2m
Average invested balance	£51.2m
Interest earned	£0.6m
Interest rate	1.19%

10. The team is also responsible for producing reports for the Nottinghamshire Pension Fund Committee and its sub-committees as well as providing advice and information on investment matters to the committee members. A work programme is maintained to assist the management of committee agendas and the scheduling of committee business. When required, reports are produced for the Pensions Working Party.

11. The Fund relies on a number of external contracts to help manage and monitor the investments. These contracts are managed, and procured when necessary, by the in-house team. The contracts include:
    - Investment management services
    - Custodian and performance monitoring services
    - Actuarial services
    - Independent advisor
    - Proxy voting services
    - Specialist investment systems

12. The team is also involved in monitoring parts of the banking services contract for both the pension fund and County Council. A tender is currently underway to procure a new provider and the team is heavily involved with this project.

13. The Fund currently has 212 active employers. A number of these employers (including all the local government employers, the colleges and the academies) are required to publish an accounting estimate of their pension liabilities in their accounts under either International Accounting Standard (IAS) 19 or its predecessor, Financial Reporting Standard (FRS) 17. The figures are calculated by the Fund's actuary on information provided by the employers and the Fund. The team co-ordinates the provision of this information and the issuing of the resulting reports.

14. IAS 19 and FRS 17 are used for the accounting estimates of pension liabilities but are not used to determine the funding level of the Fund or contributions required from employers. These result from the triennial actuarial valuation. This is a major exercise once every three

years and requires a wide range of information to be provided to the actuaries on Fund membership, cash flows and investment performance. This process is co-ordinated by the team together with the Pensions Admin office. The latest valuation, as at 31 March 2013, is currently being finalised and the initial results are reported to this Sub-Committee in a separate agenda item.

Statutory and Policy Implications

15. This report has been compiled after consideration of implications in respect of finance, the public sector equality duty, human resources, crime and disorder, human rights, the safeguarding of children, sustainability and the environment and those using the service and where such implications are material they are described below. Appropriate consultation has been undertaken and advice sought on these issues as required.

RECOMMENDATION/S

1) That the report be noted.

Report Author:
Simon Cunnington
Senior Accountant – Pensions & Treasury Management

For any enquiries about this report please contact: Simon Cunnington

Background Papers and Published Documents

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Nottinghamshire County Council

Report to Pensions Sub- Committee

6th February 2014

Agenda Item:10

REPORT OF CORPORATE DIRECTOR, POLICY, PLANNING AND CORPORATE SERVICES

WORK PROGRAMME

Purpose of the Report

1. To consider the Sub-Committee's proposed work programme for 2014.

Information and Advice

2. The County Council requires each sub-committee to maintain a work programme. The work programme will assist the management of the sub-committee's agenda, the scheduling of the sub-committee's business and forward planning. The work programme will be updated and reviewed at each pre-agenda meeting and sub-committee meeting. Any member of the sub-committee is able to suggest items for possible inclusion.

3. The attached work programme has been drafted in consultation with the Chairman and Vice-Chairman, and includes items which can be anticipated at the present time. Other items will be added to the programme as they are identified.

Other Options Considered

4. None.

Reason/s for Recommendation/s

5. To assist the sub-committee in preparing its work programme.

Statutory and Policy Implications

6. This report has been compiled after consideration of implications in respect of finance, public sector equality duty, human resources, crime and disorder, human rights, the safeguarding of children, sustainability and the environment and those using the service and where such implications are material they are described below. Appropriate consultation has been undertaken and advice sought on these issues as required.

RECOMMENDATION/S

1) That the sub-committee's work programme be noted, and consideration be given to any changes which the sub-committee wishes to make.

Jayne Francis-Ward
Corporate Director, Policy, Planning and Corporate Services

For any enquiries about this report please contact:
Chris Holmes, Team Manager Democratic Services
E-mail: **chris.holmes@nottscc.gov.uk** Tel: 0115 9773714

Constitutional Comments

7. The Sub-Committee has authority to consider the matters set out in this report by virtue of its terms of reference.

Financial Comments

8. There are no financial implications arising directly from this report.

Background Papers

Except for previously published documents, which will be available elsewhere, the documents listed here will be available for inspection in accordance with Section 100D of the Local Government Act 1972.

None

Electoral Division(s) and Member(s) Affected

All

Nottinghamshire Pension Fund Committees
Work Programme

Date	Report Title	Brief summary of agenda item	For Decision or Information ?	Lead Officer
Pensions Sub-Committee				
07-Nov-13	LGC Investment Summit 2013	Report from the LGC Investment Summit at Celtic Manor	Information	Simon Cunnington
	Property Visit 2013	Report from recent visit to some of the Fund's properties	Information	Simon Cunnington
	Working Party Recommendations	Report on recommendations from Working Party on bond investments	Decision recommendation	Simon Cunnington
	Proxy Voting - Q2&3 2013	Summary of voting activity during quarters 2 & 3 of 2013	Information	Simon Cunnington
	Local Authority Pension Fund Forum	Background on LAPFF, seeking approval for members to attend meetings	Decision recommendation	Simon Cunnington
	Investment Performance 2012/13	Presentation from Karen Thrumble of WM Company	Information & Training	
06-Feb-14	Proxy Voting - Q4 2013	Summary of voting activity during quarter 4 of 2013	Information	Simon Cunnington
	Working Party Recommendations	Report on recommendations from recent Working Party	Decision recommendation	Simon Cunnington
	LAPFF Conference	Report from the LAPFF Conference in Bournemouth	Information	Nigel Stevenson
	In-House Team & Portfolio	Report on the operation of the In-house team and portfolio	Information	Simon Cunnington
	Triennial Valuation	Draft results from the triennial valuation	Information	Simon Cunnington
08-May-14	Proxy Voting - Q1 2014	Summary of voting activity during quarter 1 of 2014	Information	Simon Cunnington
	Updates to policies	Review of fund policies and recommendation of amendments	Decision recommendation	Simon Cunnington
	Membership analysis	Analysis of membership changes and impact on cash flow	Information	Simon Cunnington
	Pension Fund Branding	Background and update on changes to pension fund branding	Information	Sarah Stevenson
	Implementation of LGPS 2014	Update on progress of implementation of the new scheme from 1/4/14	Information	Sarah Stevenson
	New Admission/Transferee bodies	Standing item to give details of any new employers within the Fund	Information	Sarah Stevenson
22-Jul-14	NAPF Local Authority Conference 2014	Report from the NAPF Local Authority Conference at the Cotswolds Water Park	Information	Simon Cunnington
	Proxy Voting - Q2 2014	Summary of voting activity during quarter 2 of 2014	Information	Simon Cunnington
	New Admission/Transferee bodies	Standing item to give details of any new employers within the Fund	Information	Sarah Stevenson